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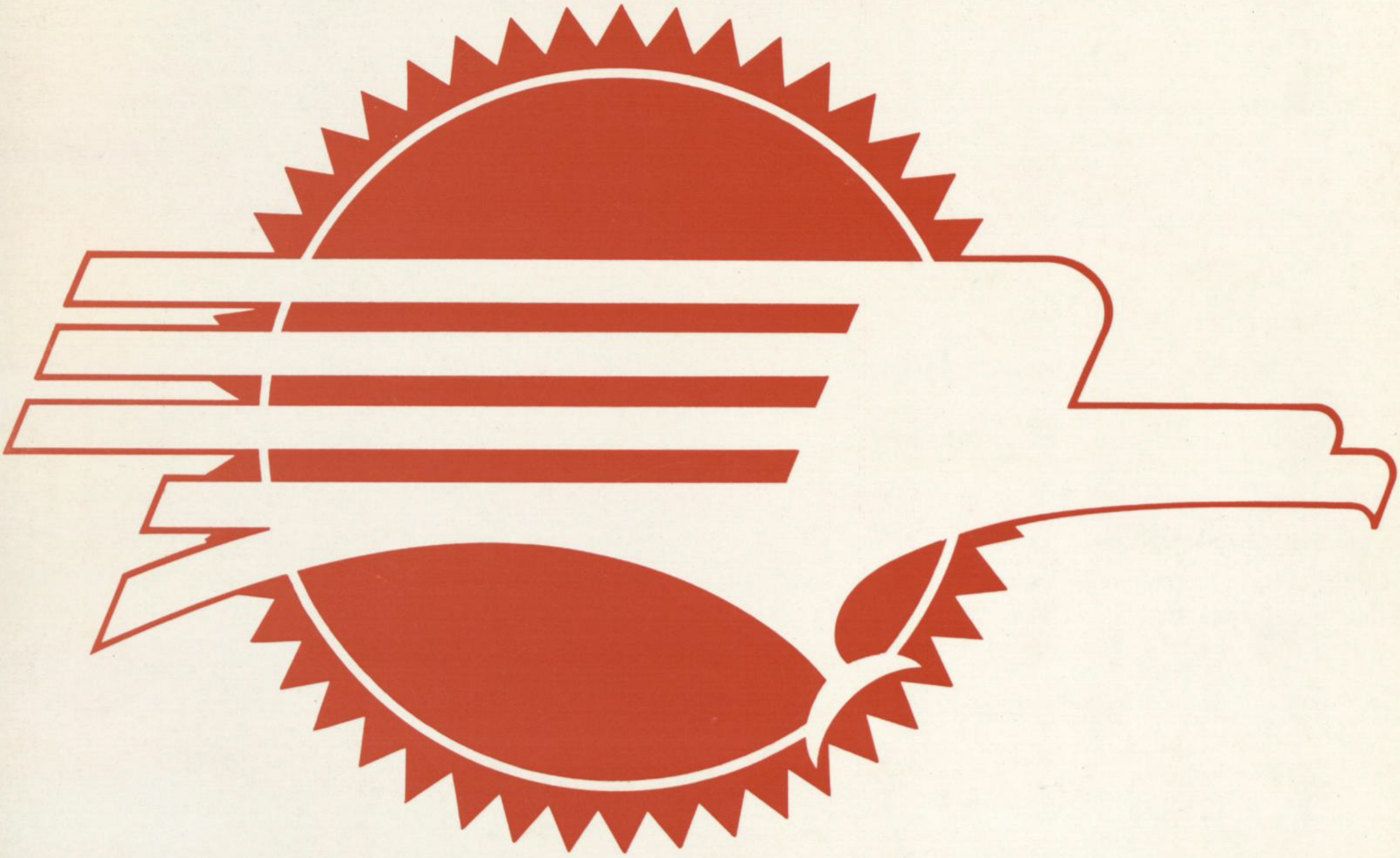


Missouri Pacific Railroad / Annual Report / '74

MISSOURI PACIFIC RAILROAD COMPANY

Transfer Agents

$1 Cumulative Convertible Preferred Stock and Common Stock

United States Trust Company of New York
45 Wall Street
New York, N. Y. 10005

The Boatmen's National Bank of St. Louis
300 No. Broadway
St. Louis, Mo. 63102

Registrars

$1 Cumulative Convertible Preferred Stock and Common Stock

Manufacturers Hanover Trust Company
One Whitehall Street
New York, N. Y. 10015

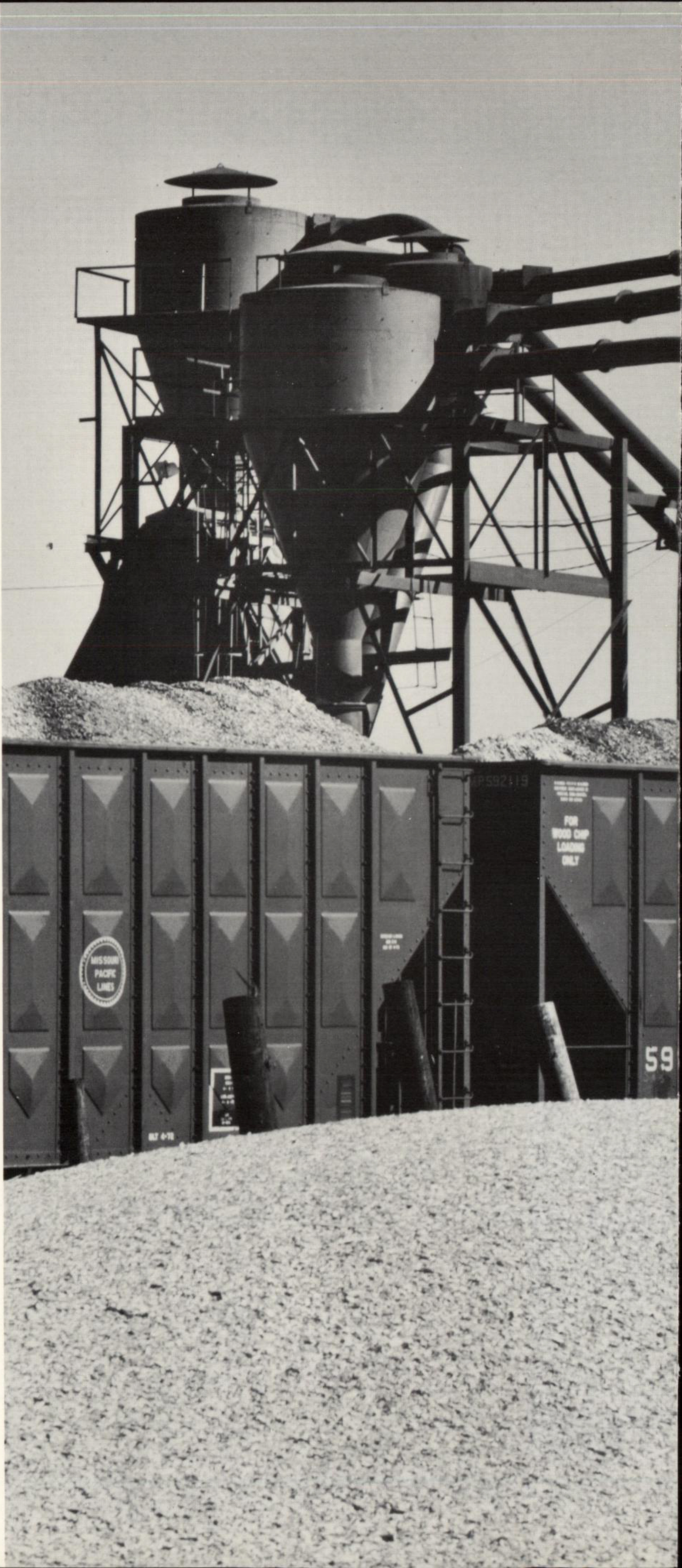
St. Louis Union Trust Company
510 Locust Street
St. Louis, Mo. 63101

Dividend Disbursing Agent

$1 Cumulative Convertible Preferred Stock and Common Stock

The Boatmen's National Bank of St. Louis

Annual Meeting of Stockholders
The Second Tuesday in May
General Offices
Missouri Pacific Building
St. Louis, Mo. 63103



Board of Directors

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▪M. R. CHAMBERS
Chairman of the Board and
Chief Executive Officer,
Interco Inc., manufacturer and
retailer of varied consumer products,
St. Louis

†▪▪SAM B. COOK
President,
The Central Trust Bank,
Jefferson City, Mo.

††ROBERT H. CRAFT
Director and Chairman of the
Finance Committee,
Missouri Pacific Railroad,
The Texas & Pacific Railway,
Chicago & Eastern Illinois Railroad,
New York

*S. M. DIXON
President,
S. M. Dixon Construction Co.,
heavy construction, principally bridges
and highways,
Warren, Ark.

R. A. GOODSON
Chairman of the Executive Committee,
Dallas Federal Savings & Loan Assn.,
Dallas

**HERBERT GUSSMAN
Independent Oil Producer and
Investments,
Tulsa

M. M. HENNELLY
Vice President and General Counsel,
Missouri Pacific Railroad,
Executive Vice President,
Mississippi River Corp.,
St. Louis

*†D. B. JENKS
Chairman of the Board,
Missouri Pacific Railroad,
The Texas & Pacific Railway,
Chicago & Eastern Illinois Railroad,
Chairman of the Board and
Chief Executive Officer,
Mississippi River Corp.,
St. Louis

*†JAMES M. KEMPER, JR.
Chairman of the Board and President,
Commerce Bancshares, Inc.,
Kansas City

*J. H. LLOYD
President and Chief Executive Officer,
Missouri Pacific Railroad,
The Texas & Pacific Railway,
Chicago & Eastern Illinois Railroad,
St. Louis

*†THOMAS H. O'LEARY
President,
Mississippi River Corp.,
Vice President-Finance,
Missouri Pacific Railroad,
St. Louis
Mississippi River Corp. controls subsidiaries involved in railroad operations (Missouri Pacific System), production/transmission of natural gas, and cement manufacturing.

*HAROLD E. THAYER
Chairman of the Board and
Chief Executive Officer,
Mallinckrodt, Inc., manufacturers of
chemicals and pharmaceuticals,
St. Louis

▪F. B. WADELTON
President,
The Insco Systems Corp.,
data processing services,
Neptune, N. J.

*Executive Committee
†Finance Committee
▪Audit Committee
**Chairman of Executive Committee
††Chairman of Finance Committee
▪▪Chairman of Audit Committee

Officers

D. B. JENKS
Chairman of the Board,
St. Louis

J. H. LLOYD
President and Chief Executive Officer,
St. Louis

D. L. MANION
Vice President-Administration,
St. Louis

M. M. HENNELLY
Vice President and
General Counsel,
St. Louis

J. A. AUSTIN
Vice President-Traffic,
St. Louis

J. W. GESSNER
Vice President-Operation,
St. Louis

T. H. O'LEARY
Vice President-Finance,
St. Louis

J. E. ANGST
Vice President,
St. Louis

H. M. HOFFMEISTER
Vice President-Purchases
& Materials, St. Louis

J. G. SHEPPARD
Vice President, Houston

H. S. VIERLING
Vice President, Chicago

T. D. RODMAN
Controller, St. Louis

C. J. MAURER
Secretary and Treasurer,
St. Louis

Missouri Pacific System Annual Report

for the year ended December 31, 1974

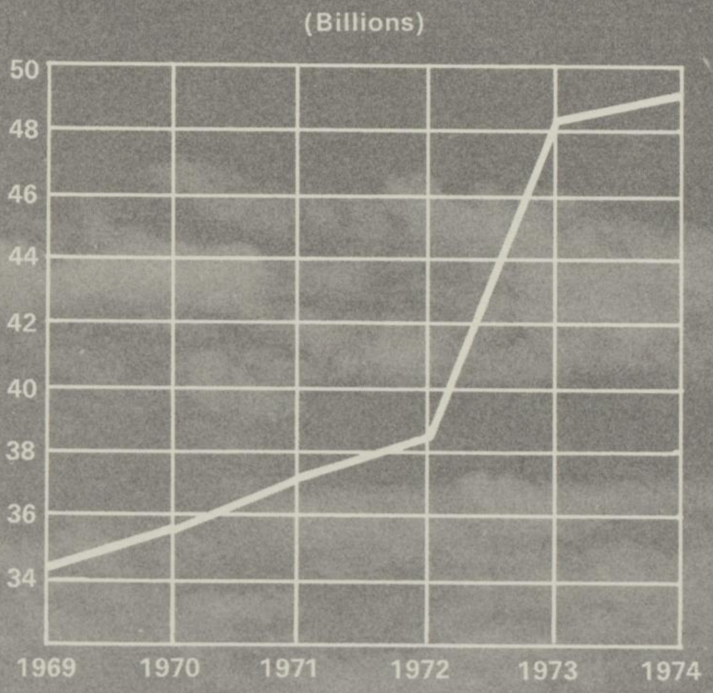
Consolidated Financial and Operating Highlights

	1974	1973
Income and Expense Items:		
Operating Revenues	**$889,857,000**	$753,582,000
Operating Expenses	**673,315,000**	584,296,000
Operating Ratio (Rail Line)	**74.2%**	75.7%
Income Available for Fixed Charges	**114,342,000**	87,917,000
Times Fixed Interest Earned	**3.6**	3.1
Net Income	**49,722,000**	30,895,000
Earnings Per Common and Common Equivalent Share (Pro Forma in 1973)	**3.98**	2.30

See Page 19 for Information Relating to the Calculation of Earnings Per Share

	1974	1973
Financial Position:		
Gross Capital Expenditures	**$104,800,000**	$ 59,388,000
Depreciation and Retirements Charged to Income	**39,297,000**	41,577,000
Working Capital	**18,755,000**	(2,417,000)
Long Term Debt	**724,845,000**	704,282,000
Freight Statistics:		
Miles of Railroad Operated	**11,738**	11,726
Revenue Ton Miles (1,000's)	**49,105,831**	48,299,769
Revenue Per Ton Mile (cents)	**1.66**	1.42
Employees:		
Total Amount of Payroll	**$341,301,000**	$317,394,000
Average Annual Wages	**14,483**	13,795
Average Number of Employees	**23,565**	23,008

MoPac System Revenue Ton Miles



To our stockholders:

The Missouri Pacific System performed strongly in 1974 despite a decline in economic activity nationally during the latter part of the year.

Records were established for net income, revenue and ton-miles of service. MoPac increased its share of the market in the region it serves and provided better service to its customers as a result of more efficient operating methods achieved in 1974.

Missouri Pacific System capital expenditures totaled $105-million in 1974, including substantial outlays for new freight cars and locomotives. Further fleet additions are included in the proposed $113-million capital improvements program for 1975.

Traffic patterns varied sharply reflecting the mixed economic performance of the nation's industries. There were increases in such major markets as chemicals, coal, paper products and intermodal traffic. The automobile, forest products and grain markets registered declines.

Notable corporate accomplishments included completion of the recapitalization plan approved in 1973 and approval by the stockholders of the Missouri Pacific Railroad, The Texas and Pacific Railway and the Chicago & Eastern Illinois Railroad to merge the latter two subsidiaries into the Missouri Pacific Railroad.

Uncertainty surrounds prospects for 1975. Expenses rose markedly in 1974 as a result of inflation and were not fully offset by additional revenue from rate increases. Fuel costs doubled and there were sharp price increases for nearly all other materials and supplies. Based upon contract agreements already announced, it is obvious that the cost for wage and fringe benefit increases for union employees will increase sharply during the next three years. Traffic declined in the latter part of 1974 and continued at a lower level through the first weeks of this year. Nor is it known what will result from shifts in national economic policy intended to curb inflation and recession.

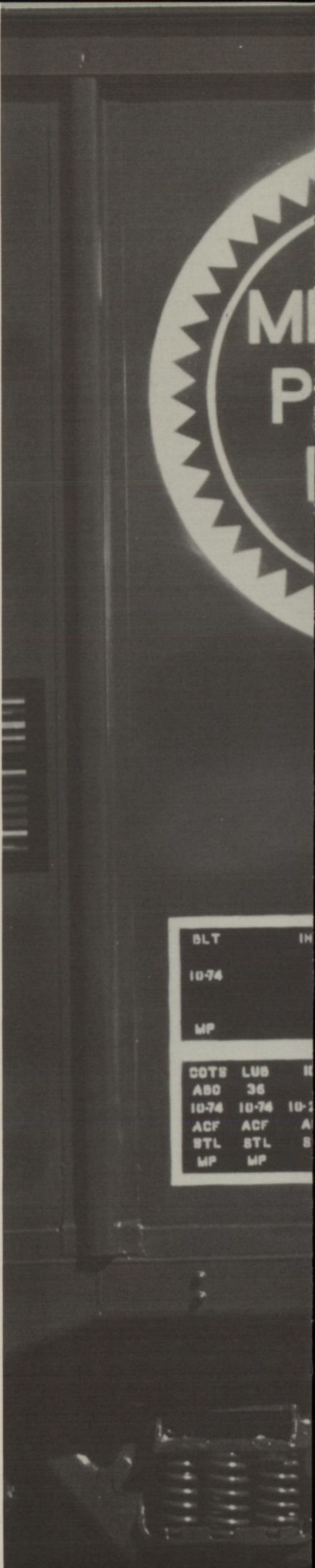
There are also favorable signs. Proposed industrial expansion in MoPac's territory remains at a high level and promises additional freight revenues. Railroad's superior fuel consumption efficiency and lower rates may lead to some diversion of truck shipments to the rails. Finally, the economy of our area has not been as hard-hit, thus far, as other parts of the nation.

If, as some economists predict, the nation will be on the way to economic recovery by mid-year, we anticipate that our performance in 1975 will continue to be satisfactory. MoPac has a solid physical plant, a modern freight car and locomotive fleet, good routes and efficient operating practices. As a result, we are in a favorable position to compete for the traffic available.

February 24, 1975

JH Lloyd

J. H. Lloyd
President and
Chief Executive Officer



SSOURI
ACIFIC
LINES
EXW 10-6 H 14-10
EW 10-0 H 15-4
IL 60-9
BLT 10-74
DUP
10-74
IW 9-6
IH 11-6
CU FT 6685
acf
MISSOURI
PACIFIC
LINES
EXW 10-6 H 14-10
EW 10-0 H 15-4
IL 60-9
BLT 10-74
DUP
10-74
NO STEP

Financial

EARNINGS AND REVENUE RECORDS: Operating revenues and earnings for the Missouri Pacific System set new records again in 1974. Consolidated revenues rose 18.1 per cent to $889.9-million from $753.6-million in 1973. Consolidated net income, on the basis of generally accepted accounting principles, increased 61 per cent to $49.7-million compared to $30.9-million last year.

Figures for the Missouri Pacific Railroad System include the accounts of the Chicago & Eastern Illinois System. The C&EI's consolidated 1974 net income was $8.8-million on revenues of $56.4-million. The comparable figures for 1973 were consolidated net income of $4.8-million and revenues of $47.1-million.

STOCK SPLITS: A 5-for-1 split of the Preferred and Common stocks was approved at the annual stockholders meeting held May 14, 1974, and authorized by the Interstate Commerce Commission the following month. As a result, the 2,000,000 shares of $5 Cumulative Preferred were increased to 10,000,000 shares of $1 Cumulative Preferred while the Common was increased from 3,000,000 to 15,000,000 shares. After these splits, which became effective July 5, there were outstanding 9,328,510 shares of $1 Preferred and 3,178,480 shares of Common stock.

Effective September 20, 1974, Missouri Pacific Common shares were listed on the American Stock Exchange. The Missouri Pacific Preferred shares are listed on the New York Stock Exchange.

MERGER: At special meetings held separately in October, 1974, shareholders of the Missouri Pacific Railroad, The Texas and Pacific Railway and the Chicago & Eastern Illinois Railroad overwhelmingly approved a plan and agreement to merge The Texas and Pacific and Chicago & Eastern Illinois roads into the Missouri Pacific.

The merger plan provides that all outstanding shares of the T&P and C&EI, except those held by the Missouri Pacific Railroad, will be exchanged for new shares of the Missouri Pacific at the ratio of 9.5 shares of MoPac Common for each share of T&P outstanding and 1.1 shares of MoPac Common for each share of C&EI outstanding. MoPac owns 96.7 per cent of the T&P stock and 78.3 per cent of the C&EI stock. This plan is now before the Interstate Commerce Commission for approval.

The merger of the three companies will be consummated as a statutory merger resulting in their complete unification with the Missouri Pacific Railroad.

DIVIDENDS AND MARKET VALUE (Adjusted for the 5-for-1 Split): The quarterly dividend on the Missouri Pacific Common Stock was increased twice during the year. Dividends of $1.10 per share were paid in 1974. The current rate is 30¢ quarterly, or $1.20 per year. The full annual dividend of $1.00 per share was paid on the Preferred Stock.

Quarterly figures showing dividends paid and market highs and lows for both classes during 1974 are shown below. Inasmuch as the former Class A and Class B stock were not comparable to the Preferred and Common stock as presently constituted, no data are shown prior to the January, 1974 recapitalization.

	QUARTER			
	First	Second	Third	Fourth
Preferred Stock				
Dividends Paid	25¢	25¢	25¢	25¢
New York Stock Exchange —				
High	$17⅜	$16¼	$15¼	$13⅞
Low	15¾	13⅝	10	10
Common Stock				
Dividends Paid	25¢	27½¢	27½¢	30¢
Over-the-counter —				
Bid —				
High	$16¾	$16⅜	$14⅞	
Low	15	13¼	9½	
Ask —				
High	17⅜	17	15⅜	
Low	15⅝	13¾	10½	
American Stock Exchange —				
High			11¾	$14
Low			10¾	10

ANNUAL REPORT FORM 12-K TO SECURITIES AND EXCHANGE COMMISSION: Interested stockholders may obtain a copy of the Company's annual report, Form 12-K, and a description of its exhibits, filed with the Securities and Exchange Commission for the year ended December 31, 1974. A copy of this report may be obtained after April 30, 1975, at no charge, upon request by writing to:

Office of the Secretary
Missouri Pacific Railroad Co.
210 N. 13th Street
St. Louis, Mo. 63103

A copy of the exhibits can be obtained by marking a checklist, which will be enclosed with our reply, and prepaying a reasonable fee.

Sales/Marketing

AN INDUSTRY LEADER: America's railroads hauled more freight last year than any year in history. Among the railroads of the nation, Missouri Pacific again was clearly a leader. Not only did MoPac establish a number of System records but also increased its share of the railroad market in the region it serves.

The diversity of the major markets it serves was a favorable factor in MoPac's success. As a result, lower levels of traffic in one market could be offset by increases in another. Grain traffic, based upon revenue ton-miles, fell 16 per cent from 1973, a year which found the railroads hauling the equivalent of two years' harvest to meet heavy export sales demand. Lumber traffic decreased 16 per cent and traffic from the automobile market declined 13 per cent. Chemical traffic rose 7 per cent while coal traffic, despite a month-long miners strike, increased 60 per cent. Iron and steel traffic climbed 20 per cent and paper products traffic was up 11 per cent.

MARKETING PROJECTS: Marketing personnel were active in many areas, engaging in both long-term and immediate projects to secure new traffic.

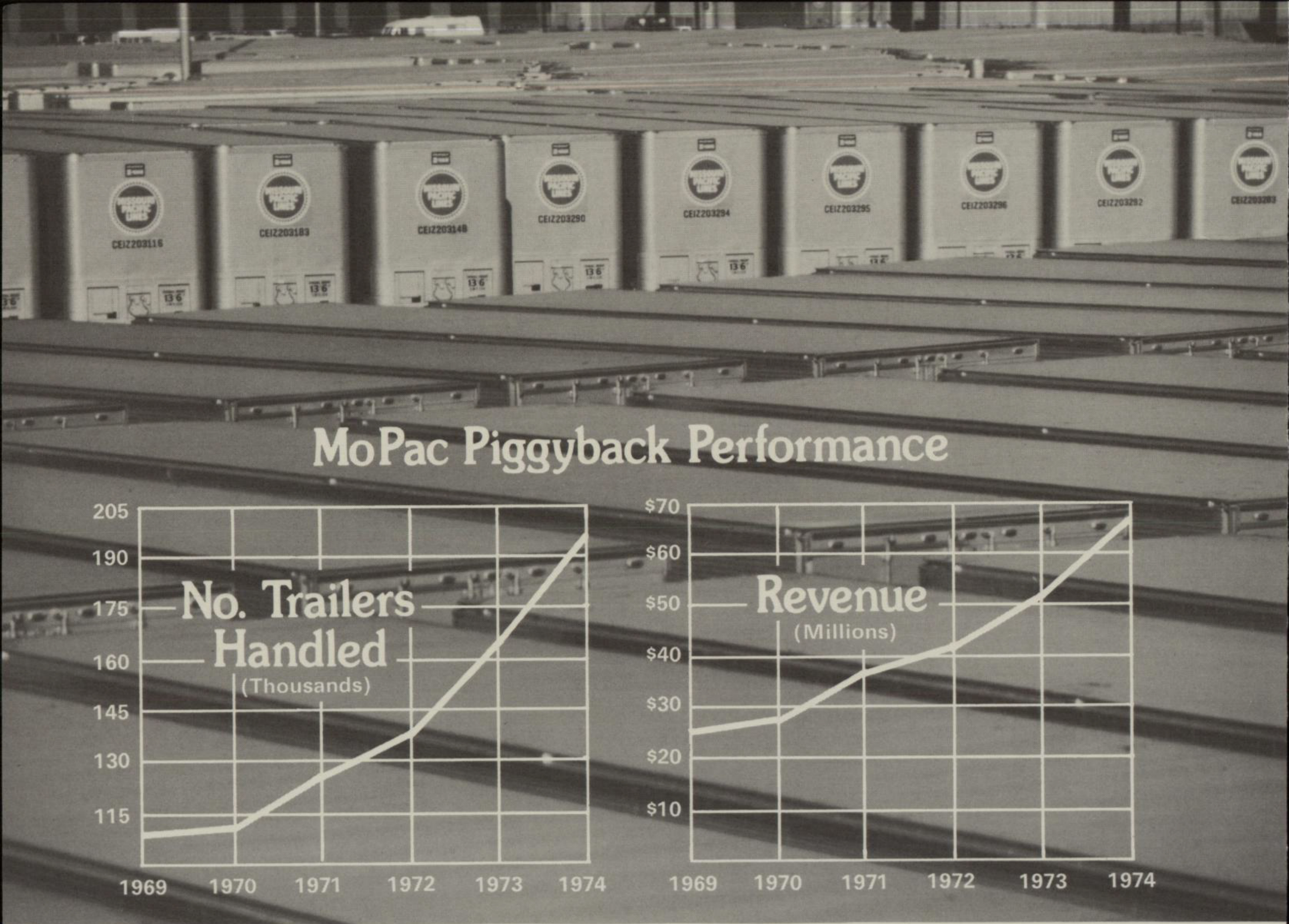
Numerous unit train rates were developed for new movements of coal, particularly from western states. Implementation of new volume rates enabled Missouri Pacific to divert a large fertilizer movement from trucks to the rails. The Company also reacquired a substantial amount of automobile business moving between Missouri and Texas. In addition, numerous pricing adjustments were made to protect chemical traffic from diversion to other modes.

One of the more important long-range programs involves development of a computerized analysis of traffic profitability on the basis of car-type, routing and specific commodity.

CANADA-MEXICO PROGRAM: A major effort to promote traffic moving between Canada and Mexico was initiated in 1974, capitalizing on MoPac's unique ability to provide single-system service between Chicago and Laredo. These cities are the two principal railroad gateways to the United States' neighboring nations.

INDUSTRIAL DEVELOPMENT: Industrial expansion along the Missouri Pacific System continued at a high level with an estimated $453-million invested in new or expanded on-line facilities. In addition, a 520-acre site was acquired last March near West Memphis, Ark. It will be developed as an industrial park by Missouri Improvement Company, a subsidiary.

During the five years 1970-74, more than 925 new or expanded industries have located along MoPac. These new facilities are important sources of traffic growth.



Intermodal Operations

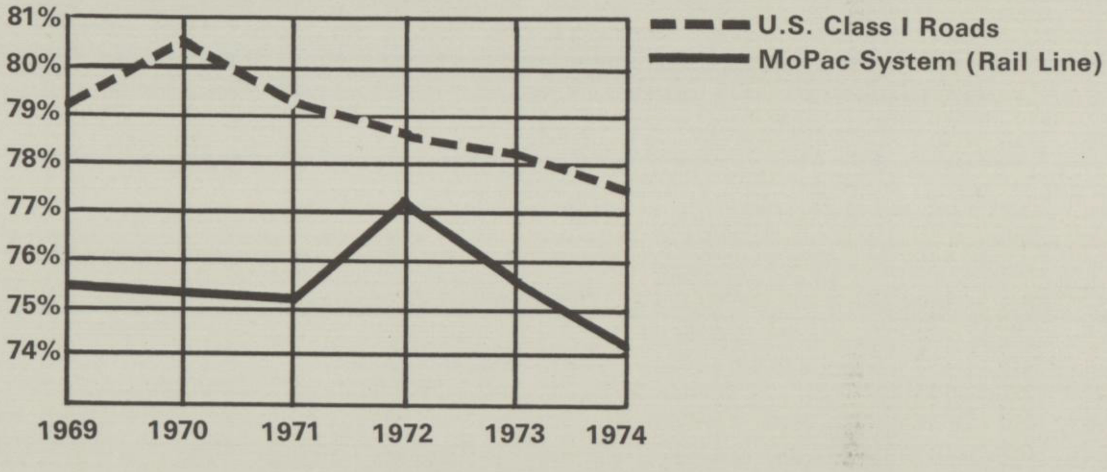
GROWTH TREND CONTINUES: MoPac continued to record strong gains in intermodal traffic. Piggyback traffic increased 20 per cent on the Missouri Pacific and 15 per cent on the Chicago & Eastern Illinois. The railroad industry, as a whole, sustained a slight drop in this type of traffic. In addition, container traffic advanced more than 60 per cent from 1973. MoPac is expected to lead the industry by a wide margin in overall intermodal traffic growth.

TRUCKING REVENUES CLIMB: Missouri Pacific Truck Lines and Texas & Pacific Motor Transport, two wholly-owned subsidiaries, had revenues of $39-million, an increase of $2.5-million from the previous year. The trucking companies invested $5.3-million for 437 units of highway equipment. They play an important role in carrying out a variety of services necessary to support MoPac's role as a total distribution company, including small shipments service, city pickup and delivery, over-the-road trucking, piggyback ramp operations and container loading and unloading.

Continued progress was made in the removal of operating restrictions governing intercity movement of trucks, thus improving operating efficiency and speed.

AIRFREIGHT PROFITABLE: Missouri Pacific Airfreight showed a modest profit in its second full year of operations. It provides airfreight forwarding service to all major U.S. airports and operates from terminals at 11 cities, including El Paso, Texas, where service began in December.

Operating Ratio



Service/Technology

OPERATING RATIO IMPROVES: Improvements in operating efficiency achieved during the year resulted in benefits both to Missouri Pacific and its customers. For the Company these improvements helped control rising costs, and increased utilization of terminals, freight cars and locomotives. Customers benefited from improved, more reliable service.

Missouri Pacific's operating ratio, which measures the amount of money spent in relation to each dollar of operating revenue, was reduced from 75.7 in 1973 to 74.2 last year. The estimated national railroad average was 77.5.

SERVICE IMPROVEMENTS: Numerous operating efficiencies were introduced or intensified in an effort to improve reliability and speed of train movements.

Six run-through train agreements were made with connecting railroads to save a day or more of transit time by avoiding interchange points. Personnel at MoPac's new Transportation Control Center, which provides opportunity for overall planning and control of service, initiated many pre-blocking, switching and scheduling changes. For example, four freight schedules were reduced 24 hours each by pre-blocking cars to eliminate switching at the Fort Worth classification yard. Good use also was made of smaller "satellite" yards where traffic from different routes can be combined into new trains and run directly through major terminals miles away without delay.

In September, Missouri Pacific joined with the Southern and the Milwaukee roads in establishing a car-balance experiment which could greatly improve car utilization.

TCS EXPANDS: Several segments of MoPac's Transportation Control System, a highly-complex and advanced management information system, were expanded over a broad area of the rail system. YATS, a computerized method of maintaining a perpetual inventory of cars in a classification yard, was installed at Memphis, Omaha, Coffeyville, Kans.; Palestine and Longview, Texas; Texarkana and North Little Rock, with more installations scheduled in 1975.

Twenty-four new Customer Service Centers were opened in 1974. These are central offices where railroad personnel can handle most service transactions with customers by telephone.

AUTOBILL IS NEW: AUTOBILL, which MoPac initiated in 1974, is a new way to prepare shipper waybills and bills of lading. It is used for traffic of a repetitive nature where commodity, shipper, receiver and routing remain constant. This information is stored in a computer for instant visual recall on a cathode ray tube device. The billing clerk punches in variable information such as weight and car number for automated preparation of the shipping documents. The system eliminates errors and accelerates bill preparation.

In order to provide the expanded computer capability demanded by TCS and other programs, two larger IBM 370/168 computer systems were installed at St. Louis to replace two units of less capacity. New minicomputer and data processing devices also were installed at field locations.

MOLU 201 5406
M.O.L. Container Service
Mits .K. Lines
CTIU 056595 9
BSH 20A
TRAI

Modernization

CAPITAL IMPROVEMENTS: Missouri Pacific System capital expenditures totaled $105-million in 1974. These expenditures represent an investment in both the present and future of the Company by enabling Missouri Pacific to have freight equipment and support facilities necessary to meet continued traffic growth.

FLEET ADDITIONS: The 1974 modernization program included the acquisition of 2,754 new freight cars

MISSOURI
PACIFIC
LINES

and 91 diesel locomotives. In addition, general or secondary repairs were performed on 5,200 freight cars. During the past five years, Missouri Pacific has acquired 12,418 new freight cars and 290 diesel locomotives. Its fleet is among the most modern in the industry.

On order for 1975, are 2,205 freight cars and 80 locomotives as part of the overall modernization program.

MAINTENANCE AND CONSTRUCTION: Upgrading of track and structures continued at a high level last year. Missouri Pacific laid 358 miles of new and relay rail, all but 12 miles of it continuous welded rail. More than 900,000 cross ties were inserted and 1.5-million cubic yards of ballast applied. New bridge construction totaled 5,766 lineal feet and 5,500 miles of track was resurfaced. Centralized Traffic Control was added to 87.3 miles of track between Bald Knob and

Briark, Ark., and several track relocation projects were completed.

About $5-million was spent on buildings, including a new District Headquarters building at North Little Rock. Intermodal terminal facilities at New Orleans were almost doubled in size as part of an extensive modernization program at the busy Gulf port city. A new intermodal terminal and office building was completed at the end of the year at Monroe, La.

People

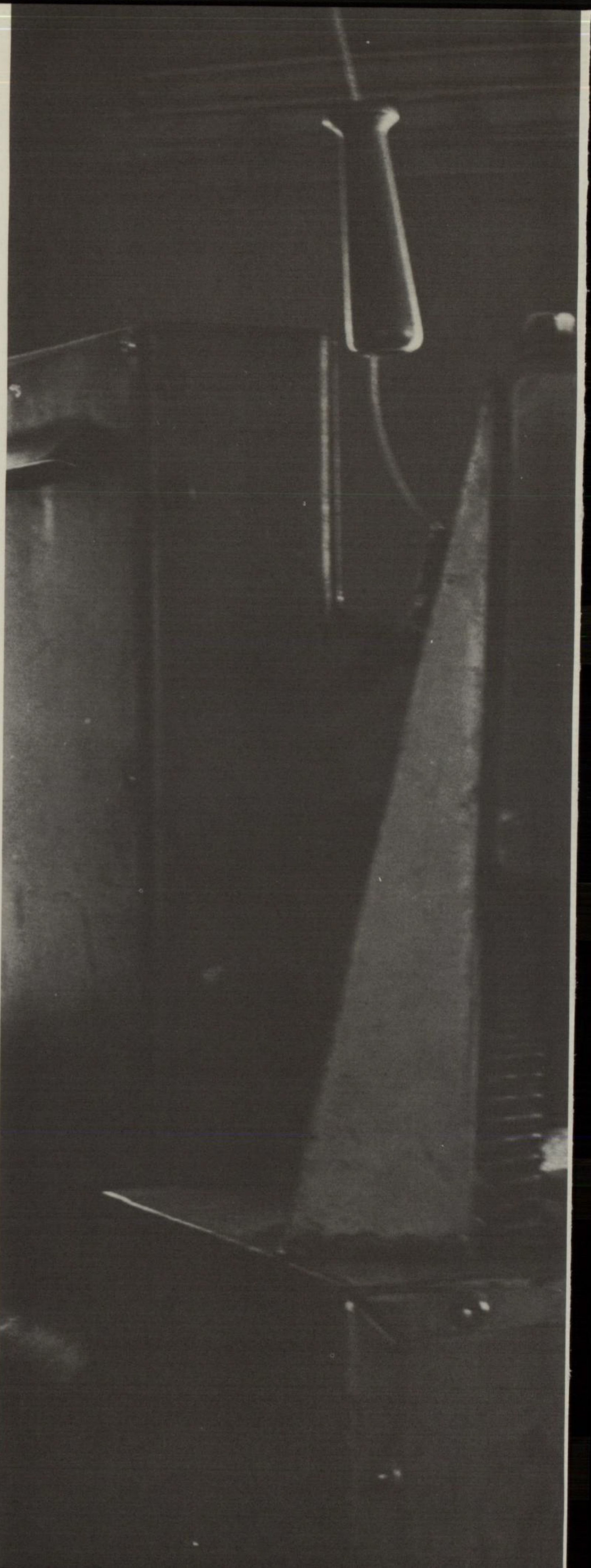
IN-HOUSE EDUCATION: In-house training of employees was expanded during the year. Included were a management training course for supervisors in the Operating Department, a four-week instruction program for switchmen and brakemen and a one-week training course for yard office employees. The Traffic Department continued its sales training and sales management workshops and completed a special educational program for sales support personnel.

OUTSIDE EDUCATION: Employees were also encouraged to upgrade their education and work skills by enrolling in schools under the Company's tuition aid program or attending special seminars. More than 400 persons utilized these opportunities. Two employees were awarded Missouri Pacific fellowships for full-time college study.

RECRUITING: The Company continued its college recruiting program and hired 115 graduates for its management development program or for direct assignment to technical areas. Both women and minorities were represented, in keeping with the Company's fair employment policy.

KEY PERSONNEL CHANGES: J. T. Suggs of Dallas left the board in December after reaching the mandatory retirement age of 70. Two members of the Missouri Pacific Railroad board of directors died during 1974. They were William B. Bates of Houston and Thomas F. Milbank of New York.

On March 14, 1974, Donald L. Manion was elected vice president-administration and James W. Gessner was elected vice president-operation.



Missouri Pacific System

Consolidated Balance Sh

Assets	**Dec. 31, 1974**	Dec. 31, 1973
Current Assets:		
Cash	**$ 18,526**	$ 17,192
Temporary Cash Investments, at cost which approximates market	**64,300**	89,325
Deposits for Interest and Dividends	**5,640**	3,807
Accounts Receivable	**72,195**	61,854
Material and Supplies, at average cost	**35,986**	18,046
Accumulated Deferred Federal Income Tax Benefits	**13,691**	13,000
Other Current Assets	**2,318**	1,282
	212,656	204,506
Properties: (Note 1)		
Road	**910,487**	894,837
Equipment	**920,369**	861,757
Miscellaneous	**30,958**	34,914
	1,861,814	1,791,508
Less:		
Accumulated Depreciation		
Road	**127,688**	122,499
Equipment	**351,097**	335,538
Miscellaneous	**11,233**	12,550
Excess of Net Assets (at acquisition) of Consolidated Subsidiaries over carrying value of investments	**53,819**	52,062
	1,317,977	1,268,859
Other Assets and Deferred Charges:		
Investment in Terminal and Other Companies	**41,500**	40,272
Capital, Insurance and Other Funds (Note 5)	**18,352**	16,561
Other	**5,735**	7,796
	65,587	64,629
	$1,596,220	$1,537,994

eet (In Thousands of Dollars)

Liabilities	Dec. 31, 1974	Dec. 31, 1973
Current Liabilities:		
Accounts and Wages Payable	**$ 103,619**	$ 89,735
Payable in Connection with Recapitalization (Note 2)	**1,023**	33,771
Current Maturities of Long Term Debt	**32,453**	29,414
Bank Loan		3,000
Unmatured Interest Accrued	**15,155**	13,907
Interest and Dividends Payable	**8,718**	8,571
Federal Income Taxes Accrued	**6,446**	4,210
Other Taxes Accrued	**13,247**	11,645
Other Current Liabilities	**13,240**	12,670
	193,901	206,923
Long Term Debt (Page 17)	**724,845**	704,282
Other Liabilities and Deferred Credits:		
Accumulated Deferred Federal Income Taxes	**181,549**	173,800
Casualty Reserves and Other Liabilities (Note 5)	**42,515**	35,905
	224,064	209,705
Equity of Minority Stockholders in Consolidated Subsidiaries	**20,522**	21,023
Stockholders' Equity: (Note 2)		
$1 Cumulative Convertible Preferred Stock, convertible on or after December 14, 1974 — No Par Value; Authorized 10,000,000 shares; Outstanding 7,754,827 and 9,328,510 shares, respectively (Owned 60.0% by Mississippi River Corporation at December 31, 1974)	**155,096**	186,570
Common Stock — No Par Value; Authorized 15,000,000 shares; Outstanding 4,752,163 and 3,178,480 shares, respectively (Owned 66.4% by Mississippi River Corporation at December 31, 1974)	**35,447**	3,973
Capital Surplus	**1,451**	1,451
Retained Income (Page 17)	**240,894**	204,067
	432,888	396,061
Commitments and Contingent Liabilities (Notes 6 and 7)		
	$1,596,220	$1,537,994

See Notes to Consolidated Financial Statements, Pages 19-24

Missouri Pacific System

Statement of Consolidated Income

(In Thousands of Dollars)

	Year Ended December 31	
	1974	1973
Operating Revenues:		
Freight	**$853,300**	$722,396
Switching and Other	**36,557**	31,186
Total Operating Revenues	**889,857**	753,582
Operating Expenses: (Notes 1 and 4)		
Maintenance of Way and Structures	**126,726**	100,669
Maintenance of Equipment	**140,095**	131,873
Traffic	**18,557**	17,028
Transportation	**356,379**	305,963
General	**31,558**	28,763
Total Operating Expenses	**673,315**	584,296
Net Revenue from Operations	**216,542**	169,286
Other Operating Charges:		
Taxes (Except Federal Income Taxes)	**67,141**	51,151
Equipment and Joint Facility Rents	**51,432**	46,288
Total Other Operating Charges	**118,573**	97,439
Net Operating Income (Before Federal Income Taxes)	**97,969**	71,847
Other Income (Net):		
Gain on Reacquisition of Long Term Debt (Note 9)	**1,009**	4,893
Other, Net	**15,364**	11,177
Total Other Income	**16,373**	16,070
Income Available for Fixed Charges (Before Federal Income Taxes)	**114,342**	87,917
Interest:		
Fixed	**31,663**	28,545
Contingent	**9,985**	10,055
Total Interest	**41,648**	38,600
Income Before Federal Income Taxes and Minority Interests	**72,694**	49,317
Provision for Federal Income Taxes: (Note 3)		
Current	**13,609**	6,433
Deferred	**7,058**	10,043
Total Federal Income Taxes	**20,667**	16,476
Income Before Minority Interests	**52,027**	32,841
Less — Income Applicable to Minority Interests	**2,305**	1,946
Net Income	**$ 49,722**	$ 30,895
Earnings Per Common and Common Equivalent Share (Pro Forma in 1973) (Notes 1, 8 and 9)	**$ 3.98**	$ 2.30
Depreciation and Retirement Charges Included Above (Note 1)	**$ 39,297**	$ 41,577

See Notes to Consolidated Financial Statements, Pages 19-24

Missouri Pacific System

Statement of Consolidated Retained Income
(In Thousands of Dollars)

	Year Ended December 31 **1974**	1973
Balance at Beginning of Year	**$204,067**	$217,066
Add — Net Income	**49,722**	30,895
	253,789	247,961
Deduct —		
Cash Dividends —		
Preferred Stock — $1.00 Per Share	**8,982**	
Common Stock — $1.10 Per Share	**3,913**	
Class A Stock		9,328
Class B Stock		795
$850 Cash Per Share of Class B Stock in Connection with the Recapitalization (Note 2)		33,771
Balance at End of Year (Note 2)	**$240,894**	$204,067

See Notes to Consolidated Financial Statements, Pages 19-24

Long Term Debt (Including Maturities in 1975)
(In Thousands of Dollars)

	Interest Rate	Date of Maturity	Changes 1974 Issued	Changes 1974 Reduction	Outstanding December 31, 1974 (excluding amounts held by Company)
Missouri Pacific Railroad Company					
First Mortgage Bonds (1)	4¼%	1990 & 2005		$ 155	$245,427
General Mortgage Bonds (1)	4¾% (2)	2020 & 2030		1,450	103,154
Income Debentures	5% (2)	2045			100,016
Equipment Obligations	4% to 11¼%	1975 to 1989	$38,276	12,589	132,566
Bank Loan	10½% (Prime)	1976 to 1978		6,000	9,000
Texas and Pacific Railway Company					
First Mortgage Bonds	5%	2000			18,961
Second Mortgage Bonds	5%	2000			4
General & Refunding Mortgage Bonds (1)	3⅞%	1985		114	6,828
First Mortgage Bonds (KO&G) (1)	3⅝%	1980		40	1,429
Equipment Obligations	4⅛% to 11%	1975 to 1989	12,317	7,672	73,652
Chicago & Eastern Illinois Railroad Company					
Income Debentures (1)	5% (2)	2054			1,704
Equipment Obligations	5% to 10½%	1975 to 1989	7,500	3,971	34,446
Other Majority-Owned Subsidiaries	4½% to 10½%	1975 to 1985		5,500	30,111
Grand Total			$58,093	$37,491	$757,298

Long Term Debt Maturing During Each of the Next Five Years	1975	1976	1977	1978	1979
	$32,453	$34,590	$32,921	$32,040	$27,289

(1) *Have annual sinking fund requirements.*

(2) *Contingent interest.*

Substantially all of the properties of the Missouri Pacific System are covered by liens of either the Missouri Pacific Railroad or The Texas and Pacific Railway mortgages or under the companies' equipment obligations.

Missouri Pacific System

Consolidated Statement of Changes in Financial Position

(In Thousands of Dollars)

	Year Ended December 31 1974	 1973
Financial Resources Were Provided By:		
Net Income	**$ 49,722**	$ 30,895
Add — Charges (Credits) Against Income Not Requiring Working Capital —		
Depreciation and Retirements	**39,297**	41,577
Increase in Long Term Casualty and Other Reserves	**7,847**	12,350
Deferred Federal Income Taxes	**7,749**	11,621
Income Applicable to Minority Interests	**2,305**	1,946
Gain on Reacquisition of Long Term Debt	**(1,009)**	(4,893)
Other, Net	**(1,027)**	144
Working Capital Provided from Operations	**104,884**	93,640
Equipment Assumed by Minority Interest in Connection with Corporate Separation of Subsidiary		15,738
Salvage from Property Sold or Retired	**16,363**	7,543
Proceeds from Sale of Investments in Securities of Santa Fe Industries, Inc.		8,618
Proceeds from Equipment Obligations Issued	**58,093**	30,517
Proceeds from Long Term Bank Loan		15,000
	179,340	171,056
Financial Resources Were Used For:		
Property Additions	**104,800**	59,388
Reduction of Long Term Equipment Obligations (Excluding Reduction Due to Corporate Separation of Subsidiary in 1973)	**32,746**	31,690
Repayment of Long Term Debt	**775**	10,349
Reduction of Long Term Bank Loan	**3,000**	3,000
Payable in Connection With Recapitalization		33,771
Distributed to Minority Interest in Connection with Corporate Separation:		
Equity of Minority Stockholder		6,825
Long Term Equipment Obligations		4,887
Accumulated Deferred Federal Income Taxes		4,179
Dividends (Including Amounts Paid Minority Interests)	**13,412**	10,448
Purchase of Securities	**1,728**	3,085
Insurance Deposit Increase	**550**	428
Capital Fund Deposit Increase	**357**	4,773
Other, Net	**800**	1,021
	158,168	173,844
Increase (Decrease) in Working Capital	**$ 21,172**	$ (2,788)
Analysis of Changes in Working Capital:		
Cash and Temporary Cash Investments	**$ (23,691)**	$ 51,490
Accounts Receivable	**10,341**	10,095
Material and Supplies	**17,940**	(189)
Accumulated Deferred Federal Income Tax Benefits	**691**	1,900
Other Current Assets	**2,869**	(12,936)
Accounts and Wages Payable	**(13,884)**	(15,729)
Payable in Connection With Recapitalization	**32,748**	(33,771)
Current Maturities of Long Term Debt	**(3,039)**	(815)
Bank Loan	**3,000**	(3,000)
Federal Income Taxes Accrued	**(2,236)**	(2,436)
Other Current Liabilities	**(3,567)**	2,603
Increase (Decrease) in Working Capital	**$ 21,172**	$ (2,788)

See Notes to Consolidated Financial Statements, Pages 19-24

Notes to Consolidated Financial Statements

NOTE 1—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Principles of financial statement preparation and consolidation — The accompanying consolidated financial statements of the Missouri Pacific System include the accounts of the Missouri Pacific Railroad Company and its majority-owned subsidiaries, principally The Texas and Pacific System (96.7% owned) and the Chicago & Eastern Illinois System (78.3% owned).

Investments in less than majority-owned terminal railroad companies (joint ventures) and other affiliated companies, where the Company has the ability to exercise significant influence over their operating and financial policies, are accounted for under the equity method.

The Company and its railroad subsidiaries maintain their books of account in conformity with principles and methods of accounting prescribed or authorized by the Interstate Commerce Commission. Prior to 1974, these principles and methods did not require provisions for deferred federal income taxes, but, effective January 1, 1974, they were revised to require such provisions. Under a policy retroactively adopted by the Company in 1973, the full amount of deferred federal income taxes has been provided for in the financial statements prepared for reports to the stockholders. Accordingly, the aforementioned revision has no effect on the accompanying consolidated financial statements which are presented in conformity with generally accepted accounting principles and include provisions for deferred federal income taxes (see federal income tax policy).

Per share data — Earnings per common and common equivalent share for 1974 include the Preferred Stock as a common stock equivalent on a

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Report of Independent Accountants

Price
Waterhouse & Co.
ONE MEMORIAL DRIVE, ST. LOUIS, MISSOURI 63102

February 14, 1975

To the Stockholders and Board of Directors of
MISSOURI PACIFIC RAILROAD COMPANY

In our opinion, the accompanying consolidated balance sheets and the related statements of consolidated income, retained income, and changes in financial position present fairly the financial position of the Missouri Pacific Railroad Company and its subsidiaries at December 31, 1974 and 1973, the results of their operations and the changes in financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Price Waterhouse & Co

one-for-one basis. The weighted average number of common shares and common share equivalents outstanding during 1974 were 12,506,990.

Earnings per common and common equivalent share are presented on a pro forma basis for 1973 assuming that (1) the January, 1974 recapitalization described in Note 2 had been effected on January 1, 1973, (2) to finance the $850 per share payment to the holders of Class B stock, the Company had borrowed on that date $33,771,000 which remained outstanding through 1973 with interest accruing at the prevailing prime rate, or $2,097,000 after tax benefits of $662,000, (3) the Preferred Stock is a common stock equivalent on a one-for-one basis, and (4) the weighted average number of common shares and common share equivalents outstanding during 1973 were 12,505,990.

Earnings per common and common equivalent share for 1974 and the weighted average number of common shares and common share equivalents outstanding during 1974 give effect to the July 5, 1974 five-for-one stock split described on page 6. Comparable pro forma share data for 1973 have been restated to reflect the stock split.

Federal income taxes — The accompanying consolidated financial statements include provisions for current and deferred federal income taxes. Current federal income taxes have been reduced by the benefits of tax deductions for accelerated depreciation and amortization of properties in advance of such deductions for financial statement purposes. These benefits have been partially offset by the effects of financial statement expense accruals for casualties and other matters which are not deducted for income tax purposes until paid and by equipment repair expenses which are capitalized for tax purposes. The net current benefit of these timing differences has been offset by a provision for deferred federal income taxes.

Investment tax credit is accounted for under the flow-through method.

Properties — Properties are stated at estimated original cost, primarily determined as of January 1, 1955 by Interstate Commerce Commission valuations, plus additions and betterments at cost and less retirements since the dates of valuations.

The companies follow the straight-line method of depreciation using various group rates prescribed by the Interstate Commerce Commission. Depreciation provisions during 1974 and 1973 were at rates of approximately 3.6% for equipment and 2.0% for depreciable road properties. However, for rails, ties and other track materials, instead of depreciation accounting, the companies follow an acceptable alternate practice of "replacement" accounting. Under this method, replacements in kind are charged to expense while additions and betterments (improvements) are capitalized. The amounts capitalized are not depreciated and are charged against income only when the related properties are retired. Normal retirements of depreciable property are charged to the appropriate depreciation reserve at cost less salvage. At December 31, 1974 and 1973, consolidated nondepreciable properties, including land and land rights, were approximately $556,000,000 and $549,000,000, respectively.

Excess of net assets (at acquisition) of consolidated subsidiaries over carrying value of investments is not being amortized.

Pensions — The companies have an unfunded, noncontributory pension plan for executives, officials and certain key employees. Related charges to operating expense represent accruals which include normal cost and amortization of prior service cost over a 35-year period beginning January 1, 1966, plus interest on the recorded unfunded pension liability.

Casualty losses — Casualty losses are accrued and charged to income as they are incurred except for major casualties covered by the self-insurance reserve described in Note 5.

Debt and related expense — Discount and expense applicable to long term debt is deferred and amortized over the lives of the respective issues using the bonds outstanding method. Gain on reacquisition of bonds is recorded as income (see Note 9).

NOTE 2—STOCKHOLDERS' EQUITY:

The Company on January 21, 1974, by an amendment to its Articles of Association, recapitalized its equity structure through the issuance of one share of $5 Cumulative Convertible Preferred Stock for each share of previously outstanding Class A Stock and the issuance of 16 shares of Common Stock, plus $850 in cash, for each share of previously outstanding

Class B Stock. This recapitalization was effected in accordance with the Settlement Agreement dated December 18, 1972, approved by the United States District Court for the Southern District of New York. The recapitalization was previously approved by both classes of the Company's stockholders at a special meeting held on June 15, 1973, and the Interstate Commerce Commission authorized the issuance of the new stocks by order effective December 14, 1973. The accompanying consolidated balance sheet as of December 31, 1973 gives effect to the recapitalization.

See page 6 for details concerning the July 5, 1974 five-for-one stock split. The number of preferred and common shares authorized and outstanding at December 31, 1973 has been restated to reflect the stock split.

Between December 14 and December 31, 1974, 1,573,683 shares of Preferred Stock were converted into an equal number of shares of Common Stock. The Common Stock account was credited with the stated value of the converted Preferred shares which increased, on a per share basis, the stated value of all shares of outstanding Common Stock from $1.25 to $7.46 per share.

At December 31, 1974, the Company has outstanding 7,754,827 shares of Preferred Stock and 4,752,163 shares of Common Stock, both classes being without par value. Each share of Preferred Stock is convertible, subject to certain dilution provisions, into one share of Common Stock on or after December 14, 1974, and is subject to redemption at the option of the Company on or after January 1, 1976, for $20 per share plus accrued dividends. Both the stated value and liquidating value are $20 per share. The Preferred Stock is non-participating and is not entitled to pre-emptive rights. The Common Stock has a stated value of $7.46 per share at December 31, 1974 and is not entitled to pre-emptive rights. Of the 15,000,000 shares of Common Stock authorized: 4,752,163 shares are outstanding; 7,754,827 shares are reserved for conversion of Preferred Stock; 972,772 shares are reserved for issuance in connection with the proposed merger described on page 6; and 1,520,238 shares are unissued and unreserved. Each share of Common Stock and each share of Preferred Stock is entitled to one vote per share and such voting rights are cumulative in the election of directors. Stockholders act by a vote of a majority of the outstanding shares of stock entitled to vote except as to certain matters as required by present Missouri law, including certain mergers, which require greater percentages of affirmative votes, and as to certain changes in preference rights which require a class vote of Preferred stockholders.

The provisions of the mortgages and indenture relative to priority of call in each year upon "Available Net Income" (as defined therein) have been satisfied and no restriction under the mortgages and indenture exists on the parent company's retained income at December 31, 1974. However, the agreement under which the Company borrowed $15,000,000 from a bank to partially finance the payments to the former Class B stockholders restricts the payment of dividends by the Company and the purchase, redemption or other retirement of any shares of capital stock of any class of the Company, by either the Company or its consolidated subsidiaries. As of December 31, 1974, $40,521,000 of consolidated retained income is not subject to these restrictions.

NOTE 3—FEDERAL INCOME TAXES:

As described in Note 1, provisions for deferred federal income taxes result from timing differences in the recognition of revenue and expense for tax and for financial statement purposes. The sources of these differences and the tax effect of each are as follows:

	Year ended December 31	
Source	1974	1973
Excess of tax over book depreciation and amortization	$15,451,000	$17,400,000
Reduction of property base for gain on reacquisition of bonds	484,000	2,345,000
Financial statement expense accruals for casualties and other matters which are not deducted for tax purposes until paid	(3,770,000)	(7,918,000)
Equipment repair expenses which are capitalized for tax purposes	(2,754,000)	
Other	(2,353,000)	(1,784,000)
Provision for deferred federal income taxes	$ 7,058,000	$10,043,000

Total tax expense amounted to $20,667,000 for 1974 and $16,476,000 for 1973, an effective tax rate of 28.4% and 33.4%, respectively. The difference between the effective rates and the federal income tax rate of 48% results primarily from investment tax credit, which has been applied under the flow-through method, as shown below:

	Year ended December 31			
	1974		1973	
	Amount	% of pre-tax income	Amount	% of pre-tax income
Tax expense computed at federal income tax rate	$34,893,000	48.0	$23,672,000	48.0
Reduction in taxes resulting from investment tax credit	(13,083,000)	(18.0)	(5,200,000)	(10.5)
Other	(1,143,000)	(1.6)	(1,996,000)	(4.1)
Actual tax expense	$20,667,000	28.4	$16,476,000	33.4

At December 31, 1974, investment tax credit carryovers of approximately $20,000,000 are available to offset future years' federal income taxes otherwise payable. Of the $20,000,000 carryover, $1,100,000 will expire in 1978, $4,500,000 in 1979, $5,500,000 in 1980 and $8,900,000 in 1981, if not used.

NOTE 4—RETIREMENT PLAN:

Pension expense as described in Note 1 resulted in charges to operating expense in 1974 and 1973 of approximately $4,212,000 and $3,401,000, respectively.

The actuarially computed value of benefits pertaining to retired employees exceeds the recorded pension plan liability by approximately $11,300,000 at December 31, 1974.

The Company is currently reviewing the requirements of the Employee Retirement Income Security Act of 1974 (ERISA) and the resultant necessary modifications in the Plan. The estimated effect of conforming the Plan to the requirements of ERISA would be to increase annual pension cost and cash outlay by approximately $1,000,000 and $3,000,000, respectively, effective January 1, 1976.

NOTE 5—CASUALTY RESERVES:

Effective February, 1972, the Company and its majority-owned subsidiaries, except for the Chicago & Eastern Illinois System, increased their insurance deductible from $1,500,000 to $5,000,000 with respect to casualty losses resulting from destroyed freight cars, freight loss and damage, personal injury and third party liability. As a result, a self-insurance reserve was established on the Company's books in 1972 to account for any such loss to the extent that it exceeds $1,500,000 and is less than $5,000,000. Estimated premium savings from increasing the deductible are added to the reserve and applicable losses are charged to it. If the reserve balance totals $5,000,000 (the maximum self-insured loss expected to occur in any one year) no additional charges are to be made against income unless the reserve declines below the maximum amount. The reserve balance was $2,830,000 and $1,782,000 at December 31, 1974 and 1973, respectively. At December 31, 1974 the Company had also set aside $6,200,000 in capital, insurance and other funds to be used in the event of self-insured losses.

NOTE 6—LEASED ASSETS AND LEASE COMMITMENTS:

The Company and its railroad subsidiaries lease a general office building and certain equipment under long term and contingent lease agreements. Certain of the Company's leases meet the criteria of a "financing lease" as defined by the Securities and Exchange Commission (SEC). Such a lease, during the noncancellable period, either (1) covers 75% or more of the economic life of the property, or (2) has terms which assure the lessor of a full recovery of the fair market value of the property at the inception of the lease plus a reasonable return.

A summary of information relating to rental expense charged to operations is presented below:

	Year ended December 31	
	1974	1973
Minimum rental expense under long term leases —		
Financing leases, as defined	$ 5,594,000	$ 4,558,000
Other	1,548,000	1,616,000
	7,142,000	6,174,000
Rental expense under contingent leases (net) —		
Hire of transportation equipment	40,393,000	37,466,000
Joint facility	4,694,000	3,381,000
Computer equipment	3,722,000	3,378,000
	48,809,000	44,225,000
	$55,951,000	$50,399,000

As of December 31, 1974, rental commitments under long term leases were as follows:

	Rental commitments pertaining to		
Periods to which commitments relate	Transportation equipment	Other	Total
1975	$ 7,312,000	$ 1,847,000	$ 9,159,000
1976	7,264,000	1,847,000	9,111,000
1977	7,184,000	1,847,000	9,031,000
1978	7,725,000	1,847,000	9,572,000
1979	8,210,000	1,847,000	10,057,000
1980 through 1984	36,494,000	4,559,000	41,053,000
1985 through 1989	18,682,000	2,300,000	20,982,000
1990 and 1991	2,006,000	728,000	2,734,000
Total	$94,877,000	$16,822,000	$111,699,000

The Company's leases on transportation equipment provide options to purchase the equipment at fair market value at the expiration of the leases. The lease on the general office building provides an option to renew the lease for four terms of five years each beginning in 1991 and an option to purchase the building for $6,000,000 at any time during the remaining life of the lease.

On the assumption that SEC-defined financing leases had been capitalized, and the related property rights amortized on a straight-line basis and interest expense computed on the basis of the present value of the declining outstanding balance of the lease commitments, the impact on net income for the years ended December 31, 1974 and 1973 would be less than three percent of the average net income for the respective three year periods then ended.

NOTE 7—CONTINGENT LIABILITIES:

The Company and its railroad subsidiaries are contingently liable as guarantors, together with other owner railroads, for principal and interest of certain obligations of various affiliated companies aggregating approximately $113,000,000 at December 31, 1974. Under terms of a service interruption policy, the Company and its railroad subsidiaries are contingently liable for additional premiums up to a maximum of $18,900,000 in the event of work stoppages on other participating roads.

NOTE 8—PLAN AND JOINT AGREEMENT OF MERGER:

See page 6 for details concerning the proposed merger of The Texas and Pacific Railway Company and the Chicago & Eastern Illinois Railroad Company into the Company.

The Company will account for the aforementioned merger under the "purchase" method of accounting. Earnings per common and common equivalent share for 1974 and pro forma earnings per common and common equivalent share for 1973 as described in Note 1 would have been decreased $.12 and $.02, respectively, assuming that the proposed merger had occurred on January 1, 1973.

NOTE 9—GAIN ON REACQUISITION OF DEBT:

On January 31, 1975 the Financial Accounting Standards Board released for comment a proposed Statement of Financial Accounting Standards relating to material gains and losses from extinguishments of debt. The proposed Statement would require that such gains or losses be classified as an extraordinary item and would be retroactively applied to all income statements presented.

During 1973, the Company reacquired bonds having a par value of $15,056,000 which resulted in a gain of $2,548,000 after a provision for deferred federal income taxes amounting to $2,345,000. If the proposed Statement were adopted in its present form and retroactively applied to 1973, net income and pro forma earnings per common and common equivalent share would not change, but the gain on reacquisition would be classified as an extraordinary item and income before extraordinary item and pro forma earnings per common and common equivalent share before extraordinary item would be decreased by $2,548,000 and $.20, respectively.

Computation and Application of Available Net Income

Income of Missouri Pacific Railroad Company and its Wholly-Owned Railway Companies
(computed on an I.C.C. basis as required by the Company's Mortgages and Indenture)
(In Thousands of Dollars)

	1974	1973
Income Before Fixed Charges and After Federal Income Taxes	**$69,605**	$54,438
Income of Wholly-Owned Railway Companies Before Fixed Charges	**4,082**	544
Road Property Retired and Charged (Credited) to Operating Expenses	**(1,228)**	439
	72,459	55,421
Less — Dividends of 100% Railway Companies Included in Missouri Pacific Income	**600**	200
Total Income Available for Fixed Charges	**71,859**	55,221
Fixed Charges	**21,435**	18,963
Available Net Income	**50,424**	36,258
Capital Expenditures Fund	**11,094**	8,688
Remaining Income	**39,330**	27,570
First Mortgage Sinking Fund	**771**	771
Remaining Income	**38,559**	26,799
Interest on General Mortgage Bonds, Series A	**2,542**	2,547
Remaining Income	**36,017**	24,252
Sinking Fund on General Mortgage Bonds, Series A	**350**	350
Remaining Income	**35,667**	23,902
Interest on General Mortgage Bonds, Series B	**2,358**	2,422
Remaining Income	**33,309**	21,480
Sinking Fund on General Mortgage Bonds, Series B	**338**	338
Remaining Income	**32,971**	21,142
Interest on Income Debentures	**5,001**	5,001
Balance	**$27,970**	$16,141

Missouri Pacific System

Condensed Statement of Consolidated Income For The Five Years Ended December 31, 1974

(In Thousands of Dollars Except Per Share Data)

	1974	1973	1972	1971	1970
Operating Revenues	**$889,857**	$753,582	$642,919	$602,620	$534,128
Operating Expenses	**673,315**	584,296	508,284	467,809	416,806
Net Revenue from Operations	**216,542**	169,286	134,635	134,811	117,322
Other Operating Charges	**118,573**	97,439	70,737	74,267	67,417
Other Income (Net)	**16,373**	16,070	5,679	5,792	8,977
Interest Expense	**41,648**	38,600	37,107	35,476	35,535
Income Before Federal Income Taxes, Minority Interests and Extraordinary Items	**72,694**	49,317	32,470	30,860	23,347
Provision for Federal Income Taxes:					
Current	**13,609**	6,433	2,681	3,272	928
Deferred	**7,058**	10,043	11,426	8,293	10,150
Less — Income Applicable to Minority Interests	**2,305**	1,946	1,733	1,185	507
Net Income Before Extraordinary Items	**49,722**	30,895	16,630	18,110	11,762
Extraordinary Items, Less Taxes and Minority Interests				(6,116)	
Net Income	**$ 49,722**	$ 30,895	$ 16,630	$ 11,994	$ 11,762
Per Share Data:					
Earnings Per Common and Common Equivalent Share (Pro Forma in 1973)	**$ 3.98**	$ 2.30			
Cash Dividends Paid:					
Preferred	**1.00**				
Common	**1.10**				
Class A		5.00	$ 5.00	$ 5.00	$ 5.00
Class B		20.00	5.00	5.00	5.00

Because of the characteristics of Missouri Pacific's two classes of stock outstanding prior to the January, 1974 recapitalization, earnings per share data, based thereon, have been omitted for the years 1970 through 1972. Per share dividends for 1974 and per share earnings for 1974 and 1973 reflect the five-for-one stock split of July 5, 1974.

Management Discussion and Analysis of Statement of Income

Year 1974 vs 1973

Operating revenues increased 18.1% in 1974. This was mainly due to a 1.7% rise in revenue ton miles and to several freight rate increases granted during 1974. To offset higher Railroad Retirement taxes, the Interstate Commerce Commission raised the 1.9% freight rate increase of October 1, 1973 to 2.6% effective January 1, 1974 and then to 2.8% on March 16. A series of rate increases aggregating 3.3%, starting with 2.1% on January 31, were allowed to absorb higher fuel costs. In addition, a general increase of 4% was approved on March 6 and 10% was granted on June 20 to cover higher material costs and deferred maintenance and delayed capital improvements. More detailed information concerning operating revenues is discussed in the forepart of this report.

Operating expenses in 1974 rose 15.2% over the previous year. Wage costs, which constitute over

50% of operating expenses, increased by 7.5%. In addition, costs for fuel and other material and supplies jumped tremendously in 1974.

Other operating charges were higher by $21.1 million. Railroad Retirement taxes increased $14.4 million due to an increase in the tax base effective January 1, 1974 and to the railroads agreeing to absorb a large portion of the employees' share as of October 1, 1973. Net amounts paid to other railroads and private car lines for the use of their equipment increased by $4.0 million.

Other income (net) increased only slightly in 1974 due to a combination of changes. Gain on reacquisition of long term debt decreased by $4.0 million in 1974. In 1973, however, there were charges of $1.2 million attributable to the writedown of investments in affiliated companies and $0.7 million due to an increase in the reserve for freight billing adjustments. These charges (no comparable items in 1974) reduced other income (net) in 1973. Interest income in 1974 was higher by $1.0 million.

Reference should be made to Note 3 of the Notes to Consolidated Financial Statements for an explanation of the fluctuation in federal income taxes for the year 1974 as compared to 1973. No comments as to fluctuations in other years will be made since the basis of computing the tax and the reasons for any fluctuations are not significantly different.

Year 1973 vs 1972

Operating revenues rose 14.7%. Revenue ton miles were up by 24.5% with grain ton miles increasing 134% which was equivalent to moving two years harvest. There were also changes in other commodities handled during the year. Automobiles, chemicals, iron and steel and paper products increased while forest products and coal declined. The Interstate Commerce Commission approved a freight rate increase of 3.0% effective August 19, 1973 and 1.9% starting on October 1, 1973.

Operating expenses increased by 15.0% and include wage costs which rose by 13.0% based upon labor agreements reached in mid-1973. Fuel costs and costs of material and supplies acquired during the year also climbed considerably.

Other operating charges include an increase of $8.0 million in Railroad Retirement taxes due to an increase in the rate and tax base effective January 1, 1973 and to the October 1, 1973 change previously mentioned. Net amounts paid other railroads and private car lines were up by $9.1 million due to a shortage of cars which developed during the movement of grain.

Other income (net) was up by $10.4 million when compared to 1972. Gain on the reacquisition of long term debt increased by $3.6 million, interest income by $3.2 million and profit from the sale of property by $2.6 million.

Year 1972 vs 1971

Operating revenues increased 6.7% while revenue ton miles were up 3.7%. A 2.5% interim freight rate increase approved February 5, 1972 was subsequently raised to 5% effective October 23, 1972.

Operating expenses rose by 8.7% in 1972 as compared to 1971. Wage costs increased by 11.7%.

Income applicable to minority interests reflects improved earnings of the Chicago & Eastern Illinois System, owned 66.8% by the MoPac on December 31, 1972.

Year 1971 vs 1970

Operating revenues were up 12.8%. Revenue ton miles increased by 3.8% and there were several freight rate increases granted. An interim increase of 8.0% approved on November 20, 1970 was finally raised to 12.0% effective April 12, 1971. There were substantial gains in the volume of automobiles, lumber, wheat and chemicals handled.

Operating expenses were higher by 12.2% with the wage component increasing by 11.8%. Labor agreements were reached with the railroad brotherhoods during the year.

Other operating charges include a $6.8 million increase in net amounts paid for the use of freight cars owned by others. Better car control and more serviceable cars corrected the increase during 1972.

Other income (net) was down by $3.2 million. In 1971 there was a $2.3 million loss on the sale of Santa Fe securities and a $2.4 million payment under the railroad's service interruption policy; however, profit from the sale of property increased by $0.8 million.

Income applicable to minority interests rose because of improved earnings of the Chicago & Eastern Illinois System, owned 61.1% by the MoPac on December 31, 1971.

The extraordinary loss of $6.1 million includes an estimated loss on discontinuance of rail passenger operations precipitated by the advent of Amtrak, which was partially offset by a gain on reacquisition of long term debt. Under current accounting principles, the material gain on the reacquisition of the long term debt of $4.5 million would have increased net income before extraordinary items by $2.3 million. Net income including extraordinary items would remain unchanged (see Note 9 of the Notes to Consolidated Financial Statements).

Texas and Pacific System

(Owned 96.7% By Missouri Pacific Railroad Company)

Statement of Consolidated Income

(In Thousands of Dollars)

	Year Ended December 31 1974	1973
Operating Revenues:		
Freight	**$158,917**	$137,463
Switching and Other	**4,752**	4,381
Total Operating Revenues	**163,669**	141,844
Operating Expenses:		
Maintenance of Way and Structures	**23,995**	19,202
Maintenance of Equipment	**27,037**	25,415
Traffic	**4,883**	4,401
Transportation	**74,128**	64,663
General	**5,283**	5,029
Total Operating Expenses	**135,326**	118,710
Net Revenue from Operations	**28,343**	23,134
Other Operating Charges:		
Taxes (Except Federal Income Taxes)	**11,815**	9,182
Equipment and Joint Facility Rents	**1,509**	1,902
Total Other Operating Charges	**13,324**	11,084
Net Operating Income (Before Federal Income Taxes)	**15,019**	12,050
Other Income (Net):		
Gain on Reacquisition of Long Term Debt	**48**	1,772
Other, Net	**3,621**	3,737
Total Other Income	**3,669**	5,509
Income Available For Fixed Charges (Before Federal Income Taxes)	**18,688**	17,559
Fixed Interest	**6,155**	5,423
Income Before Federal Income Taxes and Minority Interest	**12,533**	12,136
Provision for Federal Income Taxes:		
Current	**1,021**	1,399
Deferred	**3,687**	2,741
Total Federal Income Taxes	**4,708**	4,140
Income Before Minority Interest	**7,825**	7,996
Add — Loss Applicable to Minority Interest	**14**	6
Net Income	**$ 7,839**	$ 8,002
Depreciation and Retirement Charges Included Above	**$ 8,355**	$ 9,026

Chicago & Eastern Illinois System

(Owned 78.3% By Missouri Pacific Railroad Company)

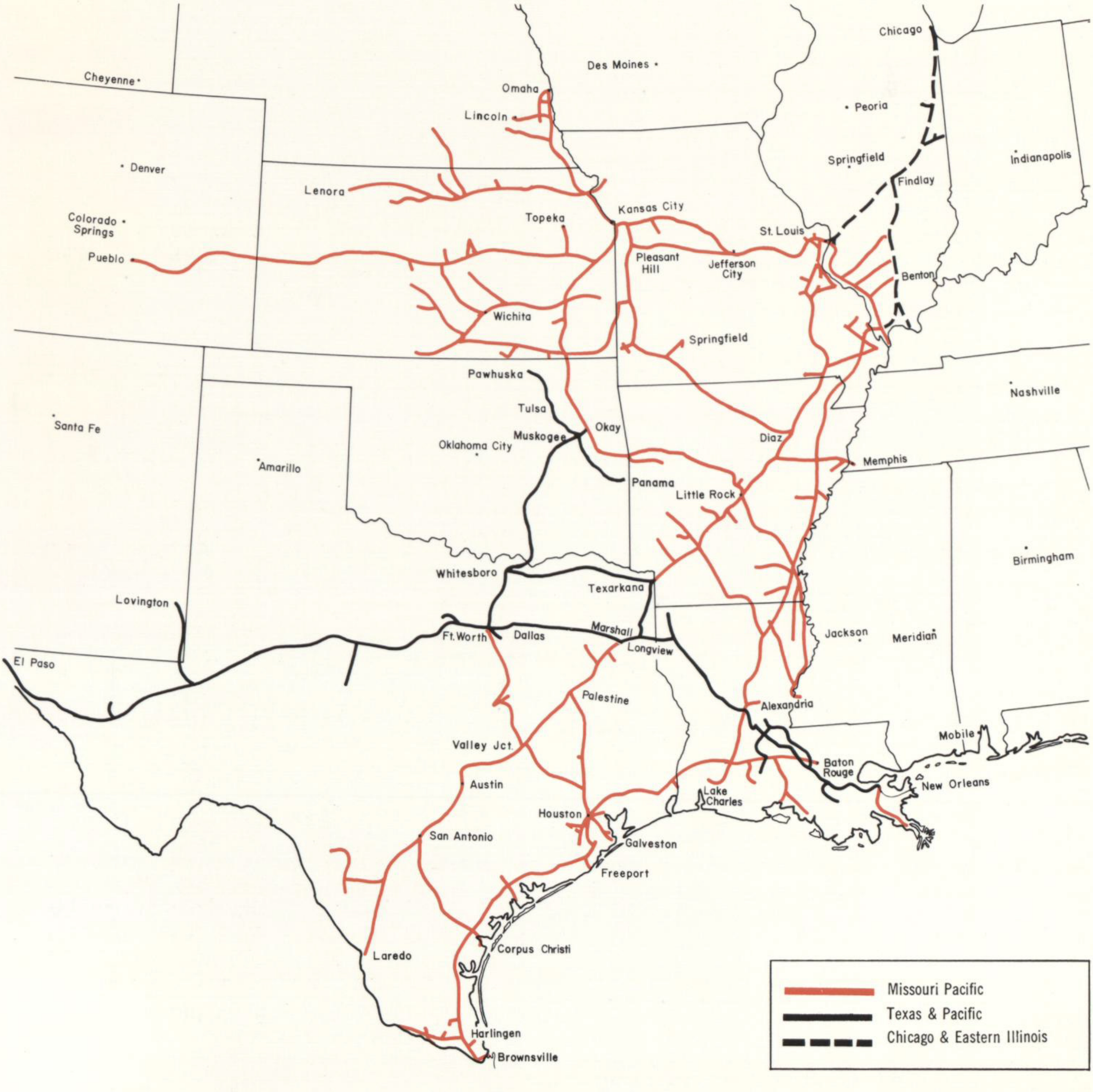
Statement of Consolidated Income

(In Thousands of Dollars)

	Year Ended December 31	
	1974	1973
Operating Revenues:		
Freight	**$ 52,767**	$ 43,687
Switching and Other	**3,655**	3,455
Total Operating Revenues	**56,422**	47,142
Operating Expenses:		
Maintenance of Way and Structures	**7,605**	8,236
Maintenance of Equipment	**8,646**	7,973
Traffic	**923**	1,114
Transportation	**19,367**	15,315
General	**2,028**	2,007
Total Operating Expenses	**38,569**	34,645
Net Revenue from Operations	**17,853**	12,497
Other Operating Charges:		
Taxes (Except Federal Income Taxes)	**4,370**	3,204
Equipment and Joint Facility Rents	**(1,112)**	461
Total Other Operating Charges	**3,258**	3,665
Net Operating Income (Before Federal Income Taxes)	**14,595**	8,832
Other Income (Net)	**542**	469
Income Available For Fixed Charges (Before Federal Income Taxes)	**15,137**	9,301
Interest:		
Fixed	**3,184**	1,852
Contingent	**85**	85
Total Interest	**3,269**	1,937
Income Before Federal Income Taxes	**11,868**	7,364
Provision for Federal Income Taxes:		
Current	**2,735**	947
Deferred	**340**	1,640
Total Federal Income Taxes	**3,075**	2,587
Net Income	**$ 8,793**	$ 4,777
Depreciation and Retirement Charges Included Above	**$ 3,437**	$ 2,909

Mo-Pac System

The MoPac System totals nearly 12,000 miles of railroad supplemented by 18,000 miles of highway routes. It has railroad operations in 12 states in the midwest, south and southwest and through its subsidiaries also performs a wide variety of intermodal services including trucking, piggyback, containerization, less-than-truckload freight and airfreight forwarding.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